

Project Name Korea-Structural Adjustment Loan

Region East Asia and Pacific

Project ID KRPE56235

Borrower Republic of Korea

Implementing Agency World Bank
1818 H Street N.W.
Washington, D.C. 20433
Telephone: (202) 458-5454
Fax: (202) 522-1500

Date PID Prepared May 3, 1998

Board Date March 26, 1998

Background

1. Country and Sector Background

The Korean economy has demonstrated strong performance for more than three decades. Since the mid-1960's, the country's gross domestic product (GDP) has grown at an average of 8.2 percent annually. Between 1991 and 1995, the economy expanded at about 7.5 percent per annum, unemployment was kept at less than 2.5 percent, and the current account deficits were in the 1 to 2 percent of GDP range. Throughout this period the government budget was in surplus in all but two years and inflation remained in the single digit range.

However, this favorable performance masked weaknesses. Although government intervention enabled Korea to grow rapidly over the last decades and become an advanced industrial economy, it also preserved a protected and inefficient financial sector as well as a highly leveraged and concentrated corporate sector. Beginning in the early 1990s, Korea's export performance also came under intense competition in the labor intensive sectors. Korea responded by relocating production to ASEAN countries and China and by investing heavily in technology-intensive sectors. Thus, in recent years, Korea has invested heavily in a narrow spectrum of "strategic" export industries, such as automobiles and electronics, making it vulnerable to demand and price changes in a few industries. In 1996, a severe cyclical downturn hit the electronics sector, and this, combined with the slowdown in other export lines, dealt a significant terms of trade blow to Korea's economy. As a result, the current account deficit more than doubled to 5 percent of GDP.

With the eruption of the financial crisis in Thailand, attention focused on some of the underlying weaknesses of the East Asian economies, and in October 1997 Korea also became the victim of regional contagion. It lost market confidence and was no longer able to attract sufficient amounts of new credits and roll over its existing obligations. On November 19, 1997, the Government formally approached the International Monetary Fund for assistance.

2. Objectives

The SAL builds on the work initiated under the Economic Reconstruction Loan (ERL), approved on December 23, 1997. The SAL will help Korea deal with the immediate foreign exchange crisis as well as support a major program of structural reforms in the financial and real sectors to lay the basis for Korea's eventual return to strong and sustained growth in the context of today's more integrated and competitive global economy.

3. Description

The SAL calls for continued adherence to sound macroeconomic policies, consistent with the macroeconomic framework agreed with the IMF, and supports structural reform in the following areas: financial sector restructuring and development; corporate sector reform, including reform of corporate governance and competition policies; labor market reform and the strengthening of social safety nets; and institutional reform in economic policy management. The loan is part of the internationally coordinated support package for Korea.

4. Financing

The loan is a single tranche loan of US\$ 2 billion. It is a single currency loan in US dollars for 15 years including 5 years' grace, at an interest rate of 6-month US dollar LIBOR (reset semiannually) plus 0.75 percent, with a service charge of 1.5 percent of the loan amount, payable on effectiveness.

5. Implementation

Korea has a strong track record in the implementation of its undertakings with the Bank. Implementation of the on-going portfolio of nine investment projects is consistently rated as either satisfactory or highly satisfactory. Commitments under the ERL are being compiled in a timely fashion. The SAL, which supports a heavy agenda, contains strong prior actions in the form of legislation or other policy measures in all the key areas of reform. Since the reform program proposed under the SAL is grounded in a medium-term framework, in addition to prior actions the government will take a number of measures whose implementation will be spread out over time. A set of indicators has been identified to monitor the effects of the policy reform supported by the SAL, and although the SAL is a single tranche operation, the dialogue with Korea on follow up operations would also provide the occasion to monitor progress on implementation of the preceding operations--including this SAL--and their outcomes.

6. Sustainability

The past 30 years have built a fundamentally strong economy with enormous physical capital resources, human resources and technological capacity. If new reforms can reconstruct the basis for allocating capital and opening markets to new competition, the country has the potential to rebound quickly.

7. Lessons learned from past operations in the country/sector

Korea has a strong track record in the implementation of its undertakings with the Bank.

8. Poverty Category

N.A.

9. Environmental Aspects

N.A.

10. Program Objective Categories

Structural reform.

Contact Point:

The InfoShop
The World Bank
1818 H Street, N.W.
Washington, D.C. 20433
Telephone No. (202)458 5454

Fax No. (202) 522 1500

Note: This is information on an evolving project. Certain activities and/or components may not be included in the final project.

Processed by the InfoShop week ending September 25, 1998.